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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Price Cap Regulation of	)	
Local Exchange Carriers	)	CC Docket No. 93-179
	)	
Rate of Return Sharing and	)	
Lower Formula Adjustment	)	

REPLY COMMENTS OF AMERITECH

Ameritech[1] submits this reply to comments to the Commission's Notice of Proposed Rulemaking in the above docket.[2]

Of thirteen parties filing comments, only four support the Commission's proposed rule change to specify that the effects of sharing and lower formula adjustments ("LFAs") to the price cap indices should not be reflected in the rate of return used to determine sharing and lower formula adjustments in the following year.

AT&T summarily supported of the Commission's proposal, stating that nothing in the price cap orders indicates that the Commission intended that the method of computing price cap local exchange carriers' ("LECs'") annual earnings be different from the method associated with rate of return regulation[3] – i.e., requiring that refunds be "added back" to calculate earnings. This rationale is somewhat puzzling. AT&T itself notes that any rule change regarding add back would have

[1] Ameritech means: Illinois Bell Telephone Company, Indiana Bell Telephone, Incorporated, Michigan Bell Telephone Company, The Ohio Bell Telephone Company, and Wisconsin Bell, Inc.

[2] In the Matter of Price Cap Regulation of Local Exchange Carriers, Rate of Return Sharing and Lower Formula Adjustment, CC Docket No. 93-179, Notice of Proposed Rulemaking, FCC 93-325 (released July 6, 1993) ("NPRM").

[3] AT&T at 5.

prospective effect only. Thus, since add back was never part of price caps originally, it is perhaps more persuasive to say that there is no indication that the Commission intended sharing to be treated the same as refunds. In fact, the evidence, as noted by the majority of comments, is just the opposite -- that sharing under price caps was not to be considered the same as refunds under rate of return regulation.

AT&T also argues that the absence of add back for sharing amounts would alter the earning ranges prescribed for implementing sharing and lower formula adjustments.[4] That argument is misguided since there are no prescribed earnings ranges under price caps. Moreover, the add back adjustment itself is a paper adjustment that results in no "cash" to benefit the company or shareholders. In other words, adding back sharing amounts increases base year earnings on paper only; it does not generate higher earnings that could be distributed to shareholders or reinvested in the business. The fact that sharing add back would require that these higher paper earnings be shared with customers is simply indicative of the flawed nature of the concept.

AT&T goes on to state that the Commission's proposal would produce "crucially important uniformity in the manner in which the LECs' current earnings are computed."[5] The short response to that argument is that uniformity is irrelevant to the issue of whether add back should be required. Uniformity could be achieved just as easily through prohibiting add back in the calculation of earnings for sharing and LFA purposes.

MCI supports the Commission's proposal for sharing only, but not for LFAs. MCI's comments demonstrate the problem with justifying the Commission's proposal by alleging the similarity of sharing add back to add back for refunds in a

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[4] Id.

[5] Id.

rate of return environment. Many of the commentors in this proceeding have amply demonstrated that the differences between sharing and refunds outnumber the similarities.[6] Nevertheless, in pursuit of its rate of return based argument, MCI correctly notes that "under rate of return regulation, the add back only applied to refunds -- never to rate increases,"[7] but then goes on to argue that this is the reason add back should apply to sharing and not LFAs. Under price cap regulation, however, sharing and the lower formula adjustment are in reality two sides of the same coin. They were implemented as part of price cap regulation by the Commission in order to allow for the fact that a single, industry-wide productivity offset was used for all price cap LECs and that that figure might be understated or overstated in the case of any single carrier.[8] That fact requires that both sharing and LFAs be treated the same for add back purposes. It also demonstrates the folly of justifying add back for sharing by likening sharing to refunds under rate of return regulation because, as MCI correctly points out, nothing like LFA "add backs" occurred under rate of return regulation. Thus, the only logical approach is to permit the effects of both sharing and LFAs to be reflected in base year earnings calculations for determining current sharing and LFA amounts.

Because of the logical necessity of treating both sharing and LFA similarly for add back purposes, NYNEX supports the Commission's proposal in its entirety.[9] NYNEX's primary argument -- that price caps would be "legally invalid" if it did not

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[6] See, e.g., Ameritech at 3, Pacific Telesis at 2; US West at 3-5; GTE at 2-3; Rochester at 2.

[7] MCI at 10.

[8] "In recognition of the difficulty of determining a single, industry-wide productivity offset that will be accurate for all LECs, the Commission adopted sharing and adjustment mechanisms to adjust rates in the event of unanticipated errors in the price cap formula." In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Order on Reconsideration, 6 FCC Rcd. 2637 (1991) (Reconsideration Order"), at ¶ 86.

[9] SNET also supports the Commission's proposal but only discusses that aspect of the change that would apply to LFAs.

require add back for both sharing and LFAs -- appears to be focused on NYNEX's desire to use the LFA to guarantee a minimum rate of return. NYNEX claims that failing to remove the effects of LFAs when determining base year returns (the "add back" counterpart for LFAs) would tend to "drive" LEC earnings below a confiscatory level.[10] However, NYNEX's argument misses a very important point -- namely that the LFA mechanism was merely intended to balance the risks and rewards of price caps (as a counter balance to sharing), but not to guarantee that any particular price cap LEC would achieve a minimum rate of return.[11] If any LEC finds itself chronically underearning, it can take the Commissions advice:

> We note also that LECs are always free to file a rate increase upon a showing that it is necessary to prevent a confiscatory outcome.[12]

Thus, those parties supporting the Commission's proposed rule change offer only conclusory and logically flawed arguments. "Add back" is inconsistent with the essential nature of sharing and LFAs -- adjustments to an individual LEC's productivity offset as a safeguard against "an error in the productivity factor, the application of an industry-wide factor to a particular LEC, or unforeseen circumstances in a particular area of the country".[13] Given that fact, to the extent that sharing and LFAs remain a part of price caps, each price cap carrier's earnings should be looked at on an actual basis from year-to-year -- unaffected by any "paper adjustment" that does nothing to either increase or decrease the actual earnings from

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[10] NYNEX at 5.

[11] It is in fact NYNEX's views of LFAs that borders on the "legally invalid". In its Attachment A, in the first sentence following the chart, NYNEX articulates its belief that an LFA operates "to prospectively recoup the shortfall from base year". That of course is not the case. If it were, it would involve retroactive ratemaking. This, however, demonstrates the defective premise on which NYNEX bases its argument that add back is required.

[12] Reconsideration Order at ¶ 117.

[13] In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd. 6786 (1990), at ¶ 147.

that year that are available to shareholders or to reinvest in the business. The Commission, therefore, should decline to adopt its proposed rule change.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Sheri L. Kostalek, do hereby certify that copies of the foregoing letter has been served to all parties on the attached service list by first class mail, postage prepaid, on this 1st day of September, 1993.

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